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HIGH PRICES AND THE THEORISTS

BY FABIAN FRANKLIN

In his article on "Gold and Prices" in the July number of this Review, Mr. Albert S. Bolles sets out with a plea for a more thorough inquiry into the causes of the prevailing high prices than has yet been made. The desire for such an inquiry is felt by none more keenly than by the leading theoretical economists of the world; they are fully aware that in addition to that agency which they recognize as most fundamental, the vast increase in the supply of gold, other causes of great importance and varied character are at work, whose nature and magnitude can be determined only by extensive and accurate research. But after its opening sentences Mr. Bolles's article is devoted to an endeavor to show that in regard to the one large cause, concerning whose operation competent economists are in substantially unanimous agreement, they are laboring under a delusion. If this were so, the outlook for any satisfactory outcome of a comprehensive inquiry into the whole complex problem would be dark indeed. "Patient inquiry" is, surely, desirable and necessary; but no amount of patience can serve as a substitute for straight thinking on the fundamental elements of a problem. That it is not the standard economists, however, but Mr. Bolles himself who has offended against the requirements of straight thinking, it is the purpose of this paper to show.

To this end it is desirable to take up first a few instances of downright and glaring fallacy; and these not incidental, but put forward with the utmost emphasis, and as conclusive proof of the wrong-headedness of the theorists. Toward the end of his article Mr. Bolles says:

"If there be any truth in the contention that the increase of gold supply has been a potent cause in moving prices upward, why has not the interest rate on gold declined? This should be the logical and natural

consequence unless some other causes have supervened. That the interest rate has advanced during recent years no one will dispute. The English and Continental financial publications especially are constantly discussing the problem. If there is any truth in the gold theorist's position, the borrower of gold or capital should say to the lender: 'Your gold that you now offer to me has diminished in value, I cannot buy as many goods with it as I could with gold formerly, so you ought to lend it at a lower rate.'"

Here Mr. Bolles makes the amazing blunder of forgetting that the interest rate is a *ratio;* that six per cent. means six dollars for the use of one hundred dollars, six cheap dollars for one hundred cheap dollars, six dear dollars for one hundred dear dollars. There is not the slightest trace of reason for either a high rate of interest or a low rate of interest going with a high *level* of prices; diminished purchasing power of the principal is precisely compensated by diminished purchasing power of the interest. That the process of *change* from high purchasing power to low purchasing power may have an effect on the rate of interest; that in a time of constantly rising prices it may be worth while for the borrower to give, and it may be possible for the lender effectively to demand, compensation for the prospective depreciation of the principal in the shape of a higher rate of interest, is perfectly possible—nay, it may be set down as certain that this has in fact taken place on a great scale. Not only, however, has Mr. Bolles no conception of all this, but he actually insists at great length on the ludicrous notion that the diminution in the value of gold should logically be accompanied by a diminution in the *percentage* of that same gold which should be paid for its use for a given time.

I have made this quotation first because the error is so palpable; it is not, however, in the main track of Mr. Bolles's argument, but seems rather added at the end by way of good measure. Near the beginning of the article the following passage occurs:

"Is not the following observation of an eminent French economist, Neymarck, unanswerable? 'There is no denying the increase in the production of gold; it has kept up for a hundred, for fifty, for twenty, for ten years, always progressing. And yet, during the interval, in France and abroad, there have been crises caused by the going down of prices—a fall in food products, in the price of land, in mineral products, coal, iron, etc. How did it happen that the gold production, which, they say, is the cause of the rise in prices nowadays, could not stop the fall in prices then?'"

So far from this being unanswerable, the answer to it ought to be obvious to every one who has given any thought to the subject; but to those who have not, the answer may be instructive, for it involves in outline the essentials of the theory of money. The level of prices depends on the one hand on the quantity of all forms of money—metallic money, paper money, substitutes for money supplied by the banking and credit system — and the effectiveness or rapidity of its circulation; and on the other hand on the volume of business transactions for the effecting of which it is used. In a given state of the mechanism of banking and credit, an increase in the volume of business, with the level of prices unchanged, requires an increased volume of money. And if the actual increase in the money supply is less than would thus be required, the level of prices tends to fall, while if the increase in the money supply is greater than would thus be required, the level of prices tends to rise. This, roughly speaking, is the quantity theory of money. No economist is so silly as to say that *any* increase in the gold supply, however trifling, is bound to be accompanied by a rise of prices, however great might at the same time have been the increase in the volume of production and trade. And yet as a refutation of the view that the enormous gold production of the last fifteen or twenty years has caused a great advance of prices, we are gravely told that there have been times when gold production increased and prices fell or failed to rise. This is as though one were to say that a torrential rain could not possibly have caused a river flood, because there are often heavy rains which cause no floods and even leave the water below its normal level. It ought to be possible for any one of adult mind to grasp the idea that the production of gold, though considerable, may for many years have been not more than sufficient to counterbalance the growing needs of business, but that when the annual addition to the world's stock of gold came to be vastly beyond all precedent, it was also beyond the amount needed for maintaining the level of prices. When it is stated that the world's gold production during the past twenty years—in round numbers seven billion dollars—was about equal to the estimated total of the world's gold production from the discovery of America to the year 1893, some idea may be gained of the folly of disposing of the quantity theory of money by an " observa-

tion " which wholly ignores all consideration of quantity; and when it is added that in the twenty years preceding 1893 not only was the production of gold barely one-third of that in the last twenty, but at the same time the stock of basic money suffered an enormous diminution through the demonetization of silver, surely every one must see that nothing is left of M. Newmarck's " unanswerable " observation.

Finally, let us take the statement which Mr. Bolles puts at the forefront of his argument:

> The gold theorist usually starts with a wrong premise. He asserts that if a bushel of wheat sells for a dollar to-day, and fifteen years ago it sold for only eighty cents, gold has lost one-fifth of its purchasing power. But if some other commodity sells for eighty cents to-day which fifteen years ago sold for a dollar, has the purchasing power of gold increased? Can gold affect the prices of two marketable commodities differently at the same time, raising the price of one and lowering the price of the other? . . . If gold alone or gold and credit combined were the chief cause of the advance in prices, *it would affect everything bought and sold in the same manner.* Consider the prices of grain, for example. The advances, instead of showing equality, show great inequality. And when we pass from one group of commodities to an entirely different group, the advances are still more unequal; in some of them there have been no advances at all."

Of course the economist does not assert that " if a bushel of wheat sells for a dollar to-day, and fifteen years ago it sold for only eighty cents, gold has lost one-fifth of its purchasing power "; Mr. Bolles himself elsewhere seems to realize, what everybody knows, that it is the rise of the general average of prices to which the economist points as resulting from an increased supply of gold. But let us pass that point over, and examine Mr. Bolles's objection for what it is worth. There is no difficulty in exposing its fallacy. The fact that some prices go up and some down does not in the least militate against the doctrine that the increase in the stock of gold operates toward the raising of all prices. When the average level of prices is stationary, some prices go up and some down; when the average is falling, some go up and some down, and when the average is rising, some go up and some down. If there is a rapid increase in the world's demand for copper without corresponding enlargement of the sources of supply or cheapening of the process of production, the price of copper will rise relatively to other things; if on the other hand scientific research should

discover a very cheap process for making aluminum out of clay, the price of aluminum would fall relatively to other things. Along with these developments bearing upon the demand and supply for copper and for aluminum, there might or might not be important changes affecting the value of gold; and if there were, it would certainly be in no way surprising if the fall in the value of gold were such as to accentuate the rise in the price of copper, and yet not enough to completely wipe out the fall in the price of aluminum. Nobody will deny that the increase of the population of New York is a " potent cause " of the rise in the value of land in that city; but there are a thousand special causes which result in some New York lots being multiplied tenfold in value during the same time in which others experience little or no advance, and still others actually fall in value. What economists say is that the increased supply of gold is a force operating toward the rise of all prices; they do not say that it has the magic quality of suppressing all the other forces which, affecting this commodity or that, tend to raise the price of one and depress the price of the other.

With these fundamental and elementary errors exposed, it would be superfluous to give any further attention to Mr. Bolles's criticism of the views of the theorists. But a few remarks as to the views which he puts forward in place of them may be worth while. That in many instances prices have been advanced through the possession of monopolistic advantages, or of the strength that comes from combination, is undeniably true; and it would be one of the great objects of that systematic inquiry which ought to be made into the whole question, to determine the extent and importance of this factor in the case. But Mr. Bolles's notion of the matter, and indeed of the whole question of how prices are made, has a naïveté which is as remarkable as is the ease with which he dismisses the theories of the economists. What they delve down into the depths of the gold mines to discover, he finds on the very surface of things:

"The managers of the trust fixed those prices and when they did so were not influenced by the increased gold supply. All the trust had to do was to demand higher prices, and it obtained them: it made the products; consumers could not get them elsewhere, and must have them, that is the whole story."

Again:

> "The heavy advance from ten cents a gallon to seventeen per gallon is not founded on gold or credit or any other material cause, but solely on the desire of the producers to enhance their gains."

Speaking of the higher wages obtained in response to the demands of labor organizations, Mr. Bolles says:

> "What has the increased gold supply had to do with these advances? Probably the labor leaders know and care as little about it as the Icelanders; they surely have never used it as an argument in support of their demands. . . . They are ever busy formulating new demands, and frankly say that this is the object of their organizations, and are as little affected by gold production while exploiting their respective fields of controversy as the farthest star."

It appears, accordingly, that in Mr. Bolles's opinion a rise in the price that a man gets for the commodity in which he deals or the service which he furnishes is sufficiently accounted for by an analysis of the state of that man's mind or of the means which he adopts for the obtaining of his desires. The question of the wherewithal at the disposal of the other party for compliance with those desires has apparently nothing to do with the case. Of course if that were so, the theorists would have to throw up the sponge: if everything turned on the state of mind of the seller, and nothing on the resources at the command of the buyer, there would be an end of the quantity theory of money. But were it not down in black and white, it would seem incredible that the fact that the labor leaders know and care nothing about increased gold supply could be regarded by anybody as proving that the existence of that supply has nothing to do with the granting of their demands. The desire for higher wages we have always with us; but whether that desire can be fulfilled or not turns on myriad factors which mold the economic situation, and among these the level of general prices is surely one of the most potent. To say that it does not operate, simply because the labor leader acts upon his feelings of the situation without any knowledge of it, is about as sensible as to say that he is not subject to the force of gravitation because he constantly maintains his equilibrium without ever having so much as heard of Sir Isaac Newton.

In tilting at the theoretical economist, there is one kind of error to which, perhaps more than to any other, the "practical man" is addicted. He is continually imagining that the economist overlooks every-day phenomena which nobody

but an idiot could actually overlook; the fact being not that the economist overlooks them, but that he looks beyond them. Everybody knows, and the economist knows as well as everybody, that to get higher prices or higher wages you have to ask for them; what the economist is concerned with is the explanation of your being able—or unable, as the case may be—to get them when you ask for them. It is true enough, as Mr. Bolles says, that the grocer " never tells you " that he raises the prices " because there is more gold around "; but this fact is not news to the theorists any more than it is to him. Unquestionably the immediate condition precedent to a rise of price is that the seller shall ask more; but economists are not to be supposed ignorant of this because they say little or nothing about it. The difference between them and him is simply that they do not regard this obvious fact as an exhaustive explanation of what happens. He offers it as proof that the economists do not know what they are talking about; which is very much as though a physicist who was explaining the action of light in the process of photography were to be silenced by pointing out to him that the thing that really happened was none of this remote business—all that you had to do to get the photograph was to press the kodak button.

There are many aspects of the phenomena of the high prices of this time which require, and would reward, patient and competent study. Economists are fully impressed with the irregularities of the rise, and the desirability of an inquiry into the causes of the most important of them. So far as regards one highly important instance, however, what has happened is only what economists have always pointed out must in the nature of the case happen, as indeed is evident enough to common sense. Nothing has been more of a commonplace in economic teaching than that a rise of prices caused by a lowering of the value of the monetary unit becomes effective much more rapidly, generally speaking, in regard to commodities than in regard to wages, and is slowest of all to affect salaries. Mr. Bolles is quite right in saying that " had there been a uniform advance," affecting salaries and wages as rapidly as other things, " the voice of discontent would never have become so loud and general "; but that this non-uniformity would exist, and that the required adjustment would be slow and painful, so far from being in contradiction to theory, is among the most familiar of the teachings of economists.

With the question of the prices of agricultural products as compared with manufactures, of middlemen's profits, of retail prices as compared with wholesale, and of the growth and influence of monopolistic combinations, the case is altogether different. These are matters of high importance, dependent upon a large and complex mass of special facts having no relation whatever to the question of the quantity of the monetary medium. To study them to any purpose would require a vast amount of systematic and expert labor. But after the facts had been accumulated with patience however great, and had been classified with skill however refined, they would still require to have centered upon them the light of thoroughly scientific thinking, in order that they might yield results of real trustworthiness and value.

To imagine that there is any opposition between theoretical thinking and practical insight is to cherish a mischievous delusion. To think correctly and fruitfully in any such subject as this of prices, it is not *sufficient* to be a theorist; but it is indispensable. A man may be a theorist and yet blunder; the man that is not a theorist, and especially the man who prides himself on not being a theorist, is sure to blunder. And he is pretty sure to blunder doubly; to blunder in what he says himself, and to blunder in what he thinks the theorists say.

FABIAN FRANKLIN.